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810 Quincy Street
P.O. Box 3140, Rapid City, South Dakota 57709
Telephone (605) 342-5630 □ e-mail: ktllp@ktllp.com

### INDEPENDENT AUDITOR'S REPORT

City Commissioners City of Summerset Summerset, South Dakota

We have audited the accompanying cash basis financial statements of the governmental activities, the business-type activities, and each major fund of the CITY OF SUMMERSET (the City), Meade County, South Dakota, as of and for the year ended December 31, 2011, which collectively comprise the City's basic financial statements as listed in the Table of Contents. These financial statements are the responsibility of the City's management. Our responsibility is to express opinions on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in <u>Government Auditing Standards</u>, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinions.

As discussed in Note 1, the City prepares its financial statements on the cash basis, which is a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position-cash basis of the governmental activities, the business-type activities, and each major fund of the City, as of December 31, 2011, and the respective changes in financial position-cash basis, thereof and for the year then ended in conformity with the basis of accounting described in Note 1.

In accordance with <u>Government Auditing Standards</u>, we have also issued our report dated September 6, 2012, on our consideration of the City's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, grant agreements, and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. This report is an integral part of an audit performed in accordance with <u>Government Auditing Standards</u>, and should be considered in assessing the results of our audit.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the City's financial statements as a whole. The management's discussion and analysis and budgetary comparison information on pages 2 through 6 and 23-25 are presented for purposes of additional analysis and are not a required part of the financial statements. The management's discussion and analysis and budgetary comparison information are the responsibility of management and were derived from and relate directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

KETEL THORSTENSON, LLP Certified Public Accountants

Ketel Thorstonen LLP

### MANAGEMENT'S DISCUSSION AND ANALYSIS DECEMBER 31, 2011

Our discussion and analysis of the City of Summerset's (the City) financial performance provides an overview of the City's financial activities for the year ended December 31, 2011, within the limitations of the City's cash basis of accounting. We encourage readers to consider it in conjunction with the City's financial statements.

#### FINANCIAL HIGHLIGHTS

The City continued to work on Public Works projects during 2011. Those projects included street light installation, building improvements, and drainage improvements (approximately \$94,000).

### USING THIS ANNUAL REPORT

This annual report is presented in a format consistent with the presentation requirements of the Governmental Accounting Standards Board (GASB) Statement No. 34, as applicable to the City's cash basis of accounting.

### **Report Components**

This annual report consists of four parts as follows:

Government-wide Financial Statements: The Statement of Net Assets and the Statement of Activities provide information about the activities of the City using a government-wide focus (or "as a whole").

**Fund Financial Statements:** Fund financial statements focus on the individual parts of City government. Fund financial statements also report the City's operations in more detail than the government-wide statements by providing information about the City's most significant ("major") funds. For *governmental activities*, these statements tell how these services were financed in the short term, as well as what remains for future spending. For *proprietary activities*, these statements offer financial information about the activities the City operates like businesses, such as water, sewer, and solid waste services.

Notes to the Financial Statements: The notes to the financial statements are an integral part of the government-wide and fund financial statements and provide expanded explanation and details regarding the information reported in the statements.

Supplementary Information: The Management's Discussion and Analysis and the Budgetary Comparison Schedules are presented for purposes of additional analysis and are not required parts of the financial statements. Such information provides users of this report with additional data that supplements the government-wide statements, fund financial statements, and notes (referred to as "the basic financial statement"). The Budgetary Comparison Schedule is presented on a budgetary basis of accounting, whereby capital outlay expenditures are reported within the respective functions rather than as a separate capital outlay function.

### **Basis of Accounting**

The City has elected to present its financial statements on a cash basis of accounting. This cash basis of accounting is a basis of accounting other than generally accepted accounting principles. Basis of accounting is a reference to when financial events are recorded, such as the timing for recognizing revenues, expenses, and their related assets and liabilities. Under the City's cash basis of accounting, revenues and expenses, and related assets are recorded when they result from cash transactions.

### MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED) DECEMBER 31, 2011

### **USING THIS ANNUAL REPORT (CONTINUED)**

### **Basis of Accounting (Continued)**

As a result of the use of this cash basis of accounting, certain assets and their related revenues, (such as accounts receivable and revenue for billed or provided services not yet collected) and liabilities and their related expenses (such as accounts payable and expenses for goods or services received but not yet paid, and accrued expenses and liabilities) are not recorded in these financial statements. Therefore, when reviewing the financial information and discussion within this annual report, the reader should keep in mind the limitations resulting from the use of the cash basis of accounting.

### Reporting the City as a Whole

### The City's Reporting Entity Presentation

This annual report includes all activities for which the City of Summerset's City Commission is fiscally responsible. These activities, defined as the City's reporting entity, are operated within separate legal entities that make up the primary government. The primary government includes the legal entity of the City of Summerset.

### The Government-wide Statement of Net Assets and the Statement of Activities

One of the most important questions asked about the City's finances is, "Is the City as a whole better off or worse off as a result of the year's activities?" The Statement of Net Assets and the Statement of Activities report information about the City as a whole and about its activities in a way that helps answer this question. These statements include all of the City's assets resulting from the use of the cash basis of accounting.

These two statements report the City's net assets and changes in them. Keeping in mind the limitations of the cash basis of accounting, you can think of the City's net assets as one way to measure the City's financial health or financial position. Over time, increases or decreases in the City's net assets are one indicator of whether its financial health is improving or deteriorating. You will need to consider other nonfinancial factors, however, such as changes in the City's sales tax base and the condition of the City's roads, to assess the overall health of the City.

In the Statement of Net Assets and the Statement of Activities, we divide the City into two kinds of activities:

Governmental activities. Most of the City's basic services are reported here, including the police, general government, streets and parks. Sales taxes, property taxes and state and federal grants finance most of these activities.

Business-type activities. The City charges a fee to customers to help it cover all or most of the cost of certain services it provides. The City's sewer system is reported here.

### Reporting the City's Most Significant Funds

### The Fund Financial Statements

The fund financial statements provide detailed information about the most significant funds, not the City as a whole. Some funds are required to be established by State law and by bond covenants. However, the City Commission establishes certain other funds to help it control and manage money for particular purposes or to show that it is meeting legal responsibilities for using certain taxes, grants, and other money. The City has two kinds of funds - Governmental and Proprietary.

### MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED) DECEMBER 31, 2011

### USING THIS ANNUAL REPORT (CONCLUDED)

### Reporting the City's Most Significant Funds (Continued)

### The Fund Financial Statements (Continued)

Governmental funds - Most of the City's basic services are reported in governmental funds, which focus on how money flows into and out of those funds and the balances left at year-end that are available for spending. These funds report the acquisition of capital assets and payments for debt principal as expenditures and not as changes to asset and debt balances. The governmental fund statements provide a detailed short-term view of the City's general government operations and the basic services it provides. Governmental fund information helps you determine (through a review of changes to fund balance) whether there are more or fewer financial resources that can be spent in the near future to finance the City's programs. The City considers the General Fund and the Tax Increment District #1 - Debt Service Fund to be its significant or major governmental funds.

**Proprietary funds** - When the City charges customers for the services it provides, these services are generally reported in proprietary funds. The City's proprietary (enterprise) fund financial statements are essentially the same as the business-type activities we report in the government-wide statements, but the fund statements provide more detail and additional information. The Sewer Fund is the only proprietary fund of the City.

### A FINANCIAL ANALYSIS OF THE CITY AS A WHOLE

### Net Assets - Cash Basis

The City's combined net assets, resulting from cash basis transactions are as follows:

		Governmental Activities		ess-Type ivities	Totals			
	<u>2011</u>	<u>2010</u>	<u>2011</u>	<u>2010</u>	<b>2011</b> 2010			
ASSETS:								
Cash and Cash Equivalents	\$ 332,293	\$ 379,326	\$ 21,571	\$ 29,933	<b>\$ 353,864 \$</b> 409,259			
Restricted Assets:								
Cash and Cash Equivalents	98,441	67,195	-		<b>98,441</b> 67,195			
TOTAL ASSETS	\$ 430,734	\$ 446,521	\$ 21,571	\$ 29,933	<b>\$ 452,305 \$ 476,454</b>			
NET ASSETS:								
Restricted	\$ 98,441	\$ 67,195	\$ -	\$ -	<b>\$ 98,441 \$</b> 67,195			
Unrestricted	332,293	379,326	21,571	29,933	<b>353,864</b> 409,259			
TOTAL NET ASSETS	\$ 430,734	\$ 446,521	\$ 21,571	\$ 29,933	<b>\$ 452,305 \$ 476,454</b>			

### MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED) DECEMBER 31, 2011

### A FINANCIAL ANALYSIS OF THE CITY AS A WHOLE (CONTINUED)

### Changes in Net Assets-Cash Basis

For the years ended December 31, 2011 and 2010, net assets of the primary government (resulting from cash basis transactions) are as follows:

	Governmental Activities			ess-Type ivities	Totals			
	<u> 2011</u>	<u>2010</u>	2011	2010	2011	2010		
Program Revenues								
Charges for Services	\$ 127,819	\$ 64,164	\$ 413,494	\$ 338,537	\$ 541,313	\$ 402,701		
General Revenues								
Property Tax	553,697	519,015	-	-	553,697	519,015		
Sales Tax	296,921	257,505	-	-	296,921	257,505		
State Shared Revenues	25,278	24,328	-	-	25,278	24,328		
Investment Income	695	769	-	-	695	769		
Debt Issued	-	857,503	-	-	-	857,503		
Miscellaneous	21,626	25,970	-	-	21,626	25,970		
Total Revenues	1,026,036	1,749,254	413,494	338,537	1,439,530	2,087,791		
Expenses								
General Government	329,858	1,073,799	-	-	329,858	1,073,799		
Public Safety	215,719	168,723	-	-	215,719	168,723		
Public Works	284,682	292,034	-	-	284,682	292,034		
Health and Welfare	4,670	4,063	-	-	4,670	4,063		
Culture and Recreation	3,508	32,893	-	-	3,508	32,893		
Conservation and Development	30,247	24,471	-	-	30,247	24,471		
Sewer	-	-	250,786	190,481	250,786	190,481		
Debt Service	344,209	152,431		-	344,209	152,431		
Total Expenses	1,212,893	1,748,414	250,786	190,481	1,463,679	1,938,895		
Transfers	171,070	145,535	(171,070)	(145,535)	-	-		
Change in Net Assets	(15,787)	146,375	(8,362)	2,521	(24,149)	148,896		
<b>Ending Net Assets</b>	\$ 430,734	\$ 446,521	\$ 21,571	\$ 29,933	\$ 452,305	\$ 476,454		

### MANAGEMENT'S DISCUSSION AND ANALYSIS (CONCLUDED) DECEMBER 31, 2011

### A FINANCIAL ANALYSIS OF THE CITY AS A WHOLE (CONCLUDED)

### **Governmental Activities**

To aid in the understanding of the Statement of Activities, some additional explanation is given. Of particular interest is the format that is significantly different from a typical Statement of Revenue, Expenses, and Changes in Fund Balance. You will notice that expenses are listed in the first column, with revenues from that particular program reported to the right. The result is a Net Change in Net Assets. This type of format highlights the relative financial burden of each of the functions on the City's taxpayers. It also identifies how much each function draws from the general revenues or if it is self-financing through fees and grants or contributions. All other governmental revenues are reported as general. It is important to note that all taxes are classified as general revenue, even if restricted for a specific purpose.

For the year ended December 31, 2011, total expenses for governmental activities, resulting from cash basis transactions, amounted to \$1,212,893.

### **Business-Type Activities**

For fiscal year 2011, the sewer fund reported net expenses over revenues of \$8,362 after transfers.

### A FINANCIAL ANALYSIS OF THE CITY'S FUNDS

Certain funds experienced noteworthy changes from the prior year and are highlighted as follows:

 On the cash basis of accounting, the General Fund reported revenues and transfers in of \$971,178 and expenditures and transfers out of \$986,965. The Sewer Fund reported net assets of \$21,571 at the end of 2011.

### General Fund Budgetary Highlights

Significant budget variances were incurred as the City did not prepare or pass supplemental budget variances for certain items which were reallocated to various expenses during the year.

### ECONOMIC FACTORS AND NEXT YEAR'S BUDGET AND RATES

For the upcoming year ending December 31, 2012, the City's budget is fairly consistent with the 2011 budget.

### CONTACTING THE CITY'S FINANCIAL MANAGEMENT

This financial report is designated to provide a general overview of the City's finances and to demonstrate the City's accountability for the money it receives. If you have questions about this report or need additional financial information contact the City of Summerset, Finance Officer, P.O. Box 783, Summerset, SD 57718.

**CITY OF SUMMERSET** 

## STATEMENT OF NET ASSETS - CASH BASIS DECEMBER 31, 2011

	Go:	iness-Type ctivities	<u>Total</u>	
ASSETS:				
Cash and Cash Equivalents	\$	332,293	\$ 21,571	\$ 353,864
Restricted Assets:				
Cash and Cash Equivalents		98,4 <u>41</u>	-	98,441
TOTAL ASSETS	\$	430,734	\$ 21,571	\$ 452,305
NET ASSETS:				
Restricted for:				
Debt Service	\$	98,441	\$ -	\$ 98,441
Unrestricted		332,293	21,571	353,864
TOTAL NET ASSETS	\$	430,734	\$ 21,571	\$ 452,305

**CITY OF SUMMERSET** 

## STATEMENT OF ACTIVITIES - CASH BASIS FOR THE YEAR ENDED DECEMBER 31, 2011

					Net (Expense) Revenue and Changes in Net Assets						
			ges for			Business-Typ					
Functions/Programs	<b>Expenses</b>	Ser	vices	4	<u>Activities</u>	<u>Activities</u>		<u>Total</u>			
Primary Government:											
Governmental Activities:											
General Government	\$ 329,858	\$	1,201	\$	(328,657)	\$ -	\$	(328,657)			
Public Safety	215,719		1,159		(214,560)	-		(214,560)			
Public Works	284,682		125,459		(159,223)	_		(159,223)			
Health and Welfare	4,670		-		(4,670)	-		(4,670)			
Culture and Recreation	3,508		-		(3,508)	-		(3,508)			
Conservation and											
Development	30,247		-		(30,247)	_		(30,247)			
Debt Service	344,209		-		(344,209)	-		(344,209)			
Total Governmental Activities	1,212,893		127,819		(1,085,074)	-		(1,085,074)			
Business-Type Activity: Sewer	250,786		413,494		•	162,708		162,708			
Total Business-Type Activities	250,786		413,494		-	162,708		162,708			
	\$ 1,463,679	\$	541,313	!	(1,085,074)	162,708		(922,366)			
Genera Taxe	al Revenues:										
	operty Taxes				553,697	_		553,697			
	les Taxes				296,921	_		296,921			
	Shared Revenue	es			25,278	_		25,278			
	stricted Investme		nos		695			695			
	ellaneous Reven		5"		21,626	_		21,626			
Transf					171,070	(171,070)	١	-1,020			
	General Revenu	es and T	ransfers		1,069,287	(171,070)		898,217			
						(212,4010)		0,0,2,1			
Change	e in Net Assets				(15,787)	(8,362)	)	(24,149)			
Net Ass	sets-December 3	1, 2010			446,521	29,933		476,454			
Net As	sets-December .	31, 2011		\$	430,734	\$ 21,571	\$	452,305			

### GOVERNMENTAL FUNDS BALANCE SHEET - CASH BASIS DECEMBER 31, 2011

(See Independent Accountant's Compilation Report)

	General <u>Fund</u>	D	x Increment istrict #1 - ebt Service <u>Fund</u>	Go	Total vernmental <u>Funds</u>
ASSETS:					
101 Cash and Cash Equivalents	\$ 270,183	\$	62,110	\$	332,293
107.1 Restricted Cash and Cash Equivalents	-		98,441		98,441
TOTAL ASSETS	\$ 270,183	\$	160,551	\$	430,734
FUND BALANCES:					
264 Restricted	\$ _	\$	98,441	\$	98,441
267 Unassigned	270,183		62,110		332,293
TOTAL FUND BALANCES	\$ 270,183	\$	160,551	\$	430,734

# GOVERNMENTAL FUNDS STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCES - CASH BASIS

### FOR THE YEAR ENDED DECEMBER 31, 2011

(See Independent Accountant's Compilation Report)

h	

	General <u>Fund</u>	Di	Increment strict #1 - bt Service <u>Fund</u>	Go	Total vernmental <u>Funds</u>
Revenue:					
310 Taxes:					
311 General Property Taxes	\$ 434,893	\$	91,757	\$	526,650
313 General Sales and Use Taxes	296,921		-		296,921
315 Amusement Taxes	26,133		-		26,133
319 Penalties and Interest on Delinquent Taxes	914		-		914
320 Licenses and Permits	35,976		-		35,976
330 Intergovernmental Revenue:					
335 State Shared Revenue:					
335.03 Liquor Tax Reversion	8,443		-		8,443
335.04 Motor Vehicle Licenses (5%)	16,835		-		16,835
338 County Shared Revenue:					
338.01 County Road Tax	1,310		-		1,310
338.99 Other	4,775		-		4,775
340 Charges for Goods and Services:					
341 General Government	1,201		-		1,201
350 Fines and Forfeits:					
351 Court Fines and Costs	1,159		-		1,159
360 Miscellaneous Revenue:					
361 Investment Earnings	43		652		695
363.01 Principal Collected by County	1,000		-		1,000
364.01 Maintenance Assessments	82,398		-		82,398
369 Other	 21,626				21,626
Total Revenue	933,627		92,409		1,026,036

## GOVERNMENTAL FUNDS STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCES - CASH BASIS (CONTINUED)

### FOR THE YEAR ENDED DECEMBER 31, 2011

(See Independent Accountant's Compilation Report)

	General Fund	D	x Increment istrict #1 - ebt Service Fund	G	Total overnmental Funds
Expenditures:					<del></del>
410 General Government:					
411 Legislative	37,808		-		37,808
412 Executive	26,334		-		26,334
413 Elections	921		•		921
414 Financial Administration	198,762		-		198,762
419 Other	66,033		-		66,033
420 Public Safety:					
421 Police	201,519		-		201,519
423 Protective Inspection	14,200		-		14,200
430 Public Works:					
431 Highways and Streets	243,641		-		243,641
432 Sanitation	41,041		-		41,041
430 Health and Welfare:					
444 Humane Society	4,670		-		4,670
450 Culture and Recreation:					
452 Parks	3,508		-		3,508
460 Conservation and Development:					
465 Planning and Zoning	30,247		-		30,247
470 Debt Service Costs	39,600		304,609		344,209
Total Expenditures	908,284		304,609		1,212,893
Other Financing Sources (Uses):					
391.01 Transfers In	37,551		212,200		249,751
511 Transfers Out	(78,681)		,		(78,681)
Total Other Financing Sources (Uses)	 (41,130)		212,200		171,070
Net Change in Fund Balances	(15,787)		-		(15,787)
Fund Balances - December 31, 2010	 285,970		160,551		446,521
Fund Balances - December 31, 2011	\$ 270,183	\$	160,551	\$	430,734

### PROPRIETARY FUND BALANCE SHEET - CASH BASIS DECEMBER 31, 2011

(See Independent Accountant's Compilation Report)

ASSETS:		Sewer <u>Fund</u>
Current Assets:		
101 Cash and Cash Equivalents	\$	21,571
TOTAL ASSETS	\$	21,571
NET ASSETS:	-	
253.90 Unrestricted Net Assets	\$	21,571
TOTAL NET ASSETS	\$	21,571

# PROPRIETARY FUND STATEMENT OF REVENUES, EXPENSES AND CHANGES IN FUND NET ASSETS - CASH BASIS FOR THE YEAR ENDED DECEMBER 31, 2011

(See Independent Accountant's Compilation Report)

	Sewer <u>Fund</u>
Operating Revenue:	
380 Charges for Goods and Services	\$ 413,494
Operating Expenses:	
410 Personal Services	92,580
420 Other Current Expense	158,206
Total Operating Expenses	 250,786
Operating Income	162,708
Transfers	
391 Transfers In	12,418
511 Transfers Out	(183,488)
Total Transfers	 (171,070)
Change in Net Assets	(8,362)
Net Assets - December 31, 2010	29,933
Net Assets - December 31, 2011	\$ 21,571

### NOTES TO FINANCIAL STATEMENTS – CASH BASIS DECEMBER 31, 2011

### 1. Summary of Significant Accounting Policies

As discussed further in Note 1.c, these financial statements are presented on a cash basis of accounting. The cash basis of accounting differs from accounting principles generally accepted in the United States of America (GAAP). Generally accepted accounting principles include all relevant Governmental Accounting Standards Board (GASB) pronouncements. In the government-wide financial statements and the fund financial statements for proprietary funds, Financial Accounting Standards Board (FASB) pronouncements and Accounting Principles Board (APB) opinions issued after November 30, 1989 have not been applied.

### a. Financial Reporting Entity:

The reporting entity of the City of Summerset (the City) consists of the primary government, which includes all of the funds, organizations, institutions, agencies, departments, and offices that make up the legal entity; those organizations for which the primary government is financially accountable; and other organizations for which the nature and significance of their relationship with the primary government are such that their exclusion would cause the financial reporting entity's financial statements to be misleading or incomplete.

### b. <u>Basis of Presentation</u>:

#### Government-wide Financial Statements:

The Statement of Net Assets and Statement of Activities display information about the reporting entity as a whole. These statements include all funds of the reporting entity. The statements distinguish between governmental and business-type activities. Governmental activities generally are financed through taxes, intergovernmental revenues, and other non-exchange revenues. Business-type activities are financed in whole or in part by fees charged to external parties for goods or services.

The statement of activities presents a comparison between direct expenses and program revenues for each segment of the business-type activities of the City and for each function of the City's governmental activities. Direct expenses are those that are specifically associated with a program or function and, therefore, are clearly identifiable to a particular function. Program revenues include (a) charges paid by recipients of goods and services offered by the programs and (b) grants and contributions that are restricted to meeting the operational or capital requirements of a particular program. Revenues that are not classified as program revenues, including all taxes, are presented as general revenues.

### Fund Financial Statements:

Fund financial statements of the reporting entity are organized into funds, each of which is considered to be a separate accounting entity. Each fund is accounted for by providing a separate set of self-balancing accounts that constitute its assets, liabilities, fund equity, revenues, and expenditures/expenses. Funds are organized into two major categories: governmental and proprietary. An emphasis is placed on major funds within the governmental and proprietary categories. A fund is considered major if it is the primary operating fund of the City or it meets the following criteria:

- 1. Total assets, liabilities, revenues, or expenditures/expenses of the individual governmental or enterprise fund are at least 10 percent of the corresponding total for all funds of that category or type, and
- 2. Total assets, liabilities, revenues, or expenditures/expenses of the individual governmental or enterprise fund are at least 5 percent of the corresponding total for all governmental and enterprise funds combined, or
- 3. Management has elected to classify one or more governmental or enterprise funds as major for consistency in reporting from year to year, or because of public interest in the fund's operations.

### NOTES TO FINANCIAL STATEMENTS – CASH BASIS (CONTINUED) DECEMBER 31, 2011

### 1. Summary of Significant Accounting Policies (Continued)

### b. <u>Basis of Presentation (Continued)</u>:

Fund Financial Statements (Continued):

The funds of the City financial reporting entity are described below:

### Governmental Funds:

<u>General Fund</u> – the General Fund is the general operating fund of the City. It is used to account for all financial resources except those required to be accounted for in another fund. The General Fund is always considered to be a major fund.

<u>Debt Service Funds</u> – debt service funds are used to account for the accumulation of resources for, and the payment of, general long-term debt principal, interest, and related costs.

Tax Increment District #1 Debt Service Fund – this fund accounts for the property tax revenue received on the tax increment district to finance debt service related to infrastructure purchases made within the tax increment district. This fund is a major fund.

### **Proprietary Funds:**

<u>Enterprise Funds</u> — enterprise funds are used to account for operations (a) that are financed and operated in a manner similar to private business enterprises, where the intent of the governing body is that the costs (expenses, including depreciation) of providing goods or services to the general public on a continuing basis be financed or recovered primarily through user charges; or (b) where the governing body has decided that periodic determination of revenues earned, expenses incurred, and/or net income is appropriate for capital maintenance, public policy, management control, accountability, or other purposes.

Sewer Fund - financed primarily by user charges, this fund accounts for the construction and operation of the municipal sanitary sewer system and related facilities (SDCL 9-48-2). This fund is a major fund.

### c. Measurement Focus and Basis of Accounting:

Measurement focus is a term used to describe how transactions are recorded within the various financial statements. Basis of accounting refers to when revenues and expenditures or expenses are recognized in the accounts and reported in the financial statements, regardless of the measurement focus.

### Measurement Focus:

In the government-wide Statement of Net Assets and Statement of Activities, both governmental and business-type activities are presented using the economic resources measurement focus, applied within the limitations of the cash basis of accounting as defined below.

In the fund financial statements, the current financial resources measurement focus or the economic resources measurement focus is used, applied within the limitations of the cash basis of accounting.

### NOTES TO FINANCIAL STATEMENTS - CASH BASIS (CONTINUED) DECEMBER 31, 2011

### 1. Summary of Significant Accounting Policies (Continued)

### c. Measurement Focus and Basis of Accounting (Continued):

### Basis of Accounting:

The government-wide Statement of Net Assets and Statement of Activities and the fund financial statements, governmental and business-type activities are presented using a cash basis of accounting, which is a basis of accounting other than GAAP.

The cash basis of accounting involves the measurement of cash and cash equivalents and changes in cash and cash equivalents resulting from cash receipt and disbursement transactions. Under the cash basis of accounting, the statement of financial position reports only cash and cash equivalents. Under the cash basis of accounting, transactions are recorded in the accounts when cash and/or cash equivalents are received or disbursed.

Under GAAP, transactions are recorded in the accounts when revenue is earned and liabilities are incurred. As a result of reporting on the cash basis of accounting, certain assets (i.e. capital assets) and their related revenues (such as accounts receivable and revenue for billed or provided services not yet collected) and certain liabilities and their related expenses (such as accounts payable and expenses for goods or services received but not yet paid, accrued expenses and liabilities, and capital asset related debt) are not recorded in these financial statements.

If the City applied GAAP, the fund financial statements for governmental funds would use the modified accrual basis of accounting, while the fund financial statements for proprietary fund types would use the accrual basis of accounting. All government-wide financial statements would be presented on the accrual basis of accounting.

### d. Deposits and Investments:

For the purpose of financial reporting, "cash and cash equivalents" includes all demand and savings accounts and investments with a term to maturity at the date of acquisition of three months or less.

### e. Capital Assets:

Under the cash basis of accounting, the City's capital assets are considered a cost of the program for which they were acquired, for the amount paid in cash, in the government-wide financial statements, the fund financial statements, and the proprietary financial statements.

### f. Long-Term Liabilities:

Under the cash basis of accounting, cash proceeds from long-term debt issuances are recorded as a receipt, while payments to creditors to reduce long-term debts are recorded as a cost of the program which benefits from the financing. Allocations are made where appropriate. Interest costs are not allocated, but are reported as a separate program cost category.

Long-term debts arising from cash transactions of all funds are not reported as liabilities in these cash basis financial statements.

### NOTES TO FINANCIAL STATEMENTS – CASH BASIS (CONTINUED) DECEMBER 31, 2011

### 1. Summary of Significant Accounting Policies (Continued)

### g. Program Revenues:

Program revenues derive directly from the program itself or from parties other than the City's taxpayers or citizenry, as a whole. Program revenues are classified into three categories, as follows:

- 1. Charges for services These arise from charges to customers, applicants, or others who purchase, use, or directly benefit from the goods, services, or privileges provided, or are otherwise directly affected by the services.
- 2. Program-specific operating grants and contributions These arise from mandatory and voluntary non-exchange transactions with other governments, organizations, or individuals that are restricted for use in a particular program.
- 3. Program-specific capital grants and contributions These arise from mandatory and voluntary non-exchange transactions with other governments, organizations, or individuals that are restricted for the acquisition of capital assets for use in a particular program.

### h. Proprietary Funds Revenue and Expense Classifications:

In the Proprietary Fund Statement of Revenues, Expenses, and Changes in Fund Net Assets – Cash Basis, revenues and expenses are classified as operating revenues and expenses unless the transactions relate to capital and related financing activities, noncapital financing activities, or investing activities.

### i. Fund Balance Classification Policies and Procedures:

### Government-wide Statements:

Equity is classified as net assets and is displayed in two components under the cash basis:

- 1. Restricted net assets Consists of net assets with constraints placed on their use either by (a) external groups such as creditors, grantors, contributors, or laws and regulations of other governments; or (b) law through constitutional provisions or enabling legislation.
- 2. Unrestricted net assets All other net assets that do not meet the definition of restricted.

### Fund Financial Statements:

Proprietary fund equity is classified the same as in the government-wide financial statements. The City uses restricted net assets first when both restricted and unrestricted net asset balances are available.

In accordance with Government Accounting Standards Board (GASB) No. 54 Fund Balance Reporting and Governmental Fund Type Definitions, which was implemented in the current year, the City classifies governmental fund balance as follows:

- 1. Non-spendable includes fund balance amounts that cannot be spent either because it is not in spendable form or because of legal or contractual constraints.
- 2. Restricted includes fund balance amounts that are constrained for specific purposes which are externally imposed by providers, such as creditors or amounts constrained due to constitutional provisions or enabling legislation.
- 3. Committed includes fund balance amounts that are constrained for specific purposes that are internally imposed by the government through formal action of the highest level of decision making authority and does not lapse at year-end.

### NOTES TO FINANCIAL STATEMENTS – CASH BASIS (CONTINUED) DECEMBER 31, 2011

### 1. Summary of Significant Accounting Policies (Continued)

- i. Fund Balance Classification Policies and Procedures (Continued):
  - 4. Assigned includes fund balance amounts that are intended to be used for specific purposes that are neither considered restricted or committed. Fund balance may be assigned by the City Council, Mayor, or Finance Officer.
  - 5. Unassigned includes positive fund balance within the General Fund which has not been classified within the above-mentioned categories and negative fund balances in other governmental funds.

The City uses restricted amounts first when both restricted and unrestricted fund balances are available. Additionally, the City would first use committed, then assigned, and lastly unassigned amounts of unrestricted fund balance when expenditures are made.

### 2. Deposits and Investments

The City follows the practice of aggregating the cash assets of various funds to maximize cash management efficiency and returns. Various restrictions on deposits and investments are imposed by statutes. These restrictions are summarized below:

Deposits - The City's cash deposits are made in qualified public depositories as defined by SDCL 4-6A-1, 9-22-6, 9-22-6.1, and 9-22-6.2, and may be in the form of demand or time deposits. Qualified depositories are required by SDCL 4-6A-3 to maintain at all times, segregated from their other assets, eligible collateral having a value equal to at least 100 percent of the public deposit accounts which exceed deposit insurance such as the FDIC and NCUA. In lieu of pledging eligible securities, a qualified public depository may furnish irrevocable standby letters of credit issued by Federal Home Loan Banks accompanied by written evidence of that bank's public debt rating, which may not be less than "AA," or a qualified public depository may furnish a corporate surety bond of a corporation authorized to do business in South Dakota.

Investments - In general, SDCL 4-5-6 permits City funds to be invested in (a) securities of the United States and securities guaranteed by the United States government either directly or indirectly including, without limitation, United States treasury bills, notes, bonds, and other obligations issued or directly or indirectly guaranteed by the United States government, or otherwise directly or indirectly backed by the full faith and credit of the United States government; provided that, for other than permanent, trust, retirement, building, and depreciation reserve funds, such securities shall either mature within eighteen months from the date of purchase or be redeemable at the option of the holder within eighteen months from the date of purchase; or (b) repurchase agreements fully collateralized by securities described in (a) and meeting the requirements of § 4-5-9, if the repurchase agreements are entered into only with those primary reporting dealers that report to the Federal Reserve Bank of New York and with the one hundred largest United States commercial banks, as measured by domestic deposits; or (c) in shares of an open-end, no-load fund administered by an investment company registered under the Federal Investment Company Act of 1940, whose shares are registered under the Federal Securities Act of 1933 and whose only investments are in securities described in (a) and repurchase agreements described in (b).

The City has no investments at December 31, 2011.

### Custodial Credit Risk:

The risk that, in the event of a depository failure, the City's deposits may not be returned to it. The City does not have a deposit policy for custodial credit risk. As of December 31, 2011, none of the City's deposits were exposed to custodial credit risk.

### NOTES TO FINANCIAL STATEMENTS – CASH BASIS (CONTINUED) DECEMBER 31, 2011

### 2. Deposits and Investments (Continued)

### Interest Rate Risk:

The City does not have a formal policy that limits investment maturities as a means of managing its exposure to fair value losses arising from increasing interest rates.

### Credit Risk:

State law limits eligible investments for the City, as discussed above. The City has no investment policy that would further limit its investment choices.

State law allows income from deposits and investments to be credited to either the General Fund or the fund making the investment. The City's policy is to credit all income from investments to the fund making the investment.

### 3. Property Taxes

Property taxes are levied on or before October 1, of the year preceding the start of the fiscal year. They attach as an enforceable lien on property, and become due and payable as of January 1, the first day of the fiscal year. Taxes are payable in two installments on or before April 30 and October 31 of the fiscal year. The City is permitted by several state statutes to levy varying amounts of taxes per \$1,000 of taxable valuation on taxable real property in the City.

### 4. Long-Term Debt

Changes in long-term debt for the year ending December 31, 2011:

	<u>1</u>	Balance 2/31/2010	Additions Deletions		1	Balance 12/31/2011		ue Within One Year	
Primary Government:									
Governmental Activities:									
Tax Increment Financing Note	\$	3,473,370	\$ -	\$	70,035	\$	3,403,335	\$	143,671
Contract for Deed		775,000	_		791		774,209		13,001
Total Primary Government	\$	4,248,370	\$ -	\$	70,826	\$	4,177,544	\$	156,672

Long-term debt at December 31, 2011 is comprised of the following:

Tax Increment Financing Note:

Tax Increment Revenue and System Revenue Bond Series 2008, including interest at 4.5 percent, with an interest only payment due June 1, 2011, then semi-annual payments of \$148,400 until the maturity date of June 2028. Secured by a mortgage on the wastewater treatment facility. Financed through Tax Increment District #1 Debt Service Fund.

\$ 3,403,335

Contract for Deed bears interest at 5.0 percent, monthly payments of \$3,300 starting January 2011 increasing by \$1,000 annually, maturing in December 2020 with a balloon payment of \$153,532. Debt is secured by building and land purchased. Financed by the General Fund.

774,209

4,177,544

The City was in compliance with debt covenants for the year ending December 31, 2011. The debt covenants consist of a bond reserve of \$98,441 recorded in the Statement of Net Assets – Cash Basis. Deposits are maintained in a savings account.

### NOTES TO FINANCIAL STATEMENTS – CASH BASIS (CONTINUED) DECEMBER 31, 2011

### 4. Long-Term Debt (Continued)

### Pledged Revenues

Tax increment financing is a method of financing improvements and development in an area which has been determined to be blighted according to the criteria set forth in SDCL 11-9. In some instances, the City pledges future tax revenues generated by the tax increment district to acquire public improvements within the established district.

The City has pledged future tax revenues generated by Tax Increment District #1 and future revenues of the Sewer Fund for the retirement of its Tax Increment Financing Note listed above. This debt was used to fund capital projects. The current principal balance plus interest at the stated applicable rate over the life of the debt represents the amount of future revenue pledged. Below is a comparison of principal and interest payments and total pledged revenue for the current year:

Current Year Principal and Interest	\$ 344,209
Pledged Revenue:	
Tax Increment Revenue	\$ 91,757
Sewer Fund Revenue	413,494
Total Pledged Revenue	\$ 505,251

The annual requirements to amortize all debt outstanding as of December 31, 2011, are as follows:

	Tax	x Increment	Fin	ancing Note	Contract	for	or Deed Total									
	Interest Principal Interest Princi		<u>Principal</u>		<u>Principal</u>		Interest Princip		Principal		Interest Principal		al Interest		<b>Principal</b>	
2012	\$	153,129	\$	143,671	\$ 38,599	\$	13,001	\$	191,728	\$	156,672					
2013		146,077		150,723	37,542		26,058		183,619		176,781					
2014		139,141		157,660	35,927		39,673		175,068		197,333					
2015		131,884		164,916	33,613		53,987		165,497		218,903					
2016		124,653		172,147	30,655		68,945		155,308		241,092					
2017-2021		495,178		988,822	76,087		572,545		571,265		1,561,367					
2022-2026		245,580		1,238,420	-		-		245,580		1,238,420					
2027-2028		15,843		386,976	 -				15,843		386,976					
Total	\$	1,451,485	\$	3,403,335	\$ 252,423	\$	774,209	\$	1,703,908	\$	4,177,544					

### 5. Retirement Plan

All employees, except for part-time employees, participate in the South Dakota Retirement System (SDRS), a cost-sharing, multiple employer public employee retirement system established to provide retirement benefits for employees of the State of South Dakota and its political subdivisions. The SDRS provides retirement, disability and survivor benefits. The right to receive retirement benefits vests after three years of credited service. Authority for establishing, administering and amending plan provisions are found in South Dakota Codified Law 3-12. The SDRS issues a publicly available financial report that includes financial statements and required supplementary information. That report may be obtained by writing to the SDRS, P.O. Box 1098, Pierre, SD 57501-1098 or by calling (605) 773-3731.

General employees are required by state statute to contribute 6 percent of their salary to the plan, while public safety and judicial employees contribute at 8 percent and 9 percent, respectively. State statute also requires the employer to contribute an amount equal to the employee's contribution. State statute also requires the employer to make an additional contribution in the amount of 6.2 percent for any compensation exceeding the maximum taxable amount for social security for general employees only. The City's share of contributions to the SDRS for the fiscal years ended December 31, 2011, 2010, and 2009 were \$11,627, \$12,194, and \$7,407, respectively, equal to the required contributions each year.

### NOTES TO FINANCIAL STATEMENTS - CASH BASIS (CONTINUED) DECEMBER 31, 2011

### 6. Risk Management

The City is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. During the period ended December 31, 2011, the City managed its risks as follows:

### **Unemployment Benefits:**

The City has elected to be self-insured and retain all risk for liabilities resulting from claims for unemployment benefits. During the year ended December 31, 2011, no claims were filed for unemployment benefits.

### Health Insurance:

The City purchases health insurance for its employees from a commercial insurance carrier. Settled claims resulting from these risks have not exceeded the liability coverage during the past three years.

### Liability Insurance:

The City joined the South Dakota Public Assurance Alliance (SDPAA), a public entity risk pool currently operating as a common risk management and insurance program for South Dakota local government entities. The objective of the SDPAA is to administer and provide risk management services and risk sharing facilities to the members and to defend and protect the members against liability, to advise members on loss control guidelines and procedures, and provide them with risk management services, loss control and risk reduction information and to obtain lower costs for that coverage. The City's responsibility is to promptly report to and cooperate with the SDPAA to resolve any incident which could result in a claim being made by or against the City. The City pays an annual premium, to provide liability coverage detailed below, under a claims-made policy, and the premiums are based on their exposure or type of coverage to the pool to provide coverage for general liability, officials' liability, automobile liability and damage, property damage and law enforcement liability.

The agreement with the SDPAA provides that the above coverage will be provided to a \$2,000,000 limit. Member premiums are used by the pool for payment of claims and to pay for reinsurance for claims in excess of \$250,000 for property coverage and \$500,000 for liability coverage to the upper limit. A portion of the member premiums are also allocated to a cumulative reserve fund.

The City would be eligible to receive a refund for a percentage of the amount allocated to the cumulative reserve fund on the following basis:

End of the City's First Full Year	50%
End of the City's Second Full Year	60%
End of the City's Third Full Year	70%
End of the City's Fourth Full Year	80%
End of the City's Fifth Full Year	90%
End of the City's Sixth Full Year and Thereafter	100%

As of the December 31, 2011, the City has a vested balance in the cumulative reserve fund of \$11,036, which is not recorded in the cash basis financial statements of the City.

The City does not carry additional insurance to cover claims in excess of the upper limit. Settled claims resulting from these risks have not exceeded the liability coverage during the past three years.

### NOTES TO FINANCIAL STATEMENTS – CASH BASIS (CONCLUDED) DECEMBER 31, 2011

### 6. Risk Management (Continued)

### Worker's Compensation:

The City joined the South Dakota Municipal League Worker's Compensation Fund, a public entity risk pool currently operating as a common risk management and insurance program for South Dakota local government entities. The objective of the fund is to formulate, develop, and administer, on behalf of the member organizations, a program of worker's compensation coverage, to obtain lower costs for that coverage, and to develop a comprehensive loss control program. The City's responsibility is to initiate and maintain a safety program to give its employees safe and sanitary working conditions and to promptly report to and cooperate with the Fund to resolve any worker's compensation claims. The City pays an annual premium, to provide worker's compensation coverage for its employees, under a self-funded program and the premiums are accrued based on the ultimate cost of the experience to date of the Fund members. Coverage limits are set by state statute. The pool pays the first \$650,000 of any claim per individual. The pool has reinsurance which covers up to an additional \$2,000,000 per individual per incident.

The City does not carry additional insurance to cover claims in excess of the upper limit. Settled claims resulting from these risks have not exceeded the liability coverage during the past three years.

### 7. Interfund Transfers

Interfund transfers for the year ended December 31, 2011, were as follows:

	 Transfer In	Transfer Out		
Tax Increment District #1 - Debt Service Fund	\$ 212,200	\$ -		
Sewer Fund	12,418	183,488		
General Fund	37,551	78,681		
Total	\$ 262,169	\$ 262,169		

A transfer was made during the year between the Tax Increment District #1 - Debt Service Fund and the Sewer Fund to make the payments on the wastewater treatment plant note. An additional transfer was made between the Sewer and General Fund for operations.

### 8. Subsequent Event

Subsequent to year end, the City was awarded a \$225,000 SRF loan and a \$25,000 grant for the installation of reed beds at the Wastewater Treatment Plan. In addition, the City was awarded a FEMA grant of \$412,033 for the Castlewood Drainage Project.



# BUDGETARY COMPARISON SCHEDULE - BUDGETARY BASIS GENERAL FUND FOR THE YEAR ENDED DECEMBER 31, 2011

						udgetary Basis -		
		Budgeted	Am	ounts		Actual		
	Original Final			<u>Final</u>	A	<u>Amounts</u>	$\underline{\mathbf{v}}$	<u>ariance</u>
Revenue:								
310 Taxes:								
311 General Property Taxes	\$	457,318	\$	454,790	\$	434,893	\$	(19,897)
313 General Sales and Use Taxes		280,000		276,000		296,921		20,921
315 Amusement Taxes		19,000		19,000		26,133		7,133
319 Penalties and Interest on Delinquent Taxes		500		500		914		414
320 Licenses and Permits		29,000		37,090		35,976		(1,114)
330 Intergovernmental Revenue:								
335 State Shared Revenue:								
335.03 Liquor Tax Reversion		7,500		7,500		8,443		943
335.04 Motor Vehicle Licenses (5%)		15,000		18,010		16,835		(1,175)
338 County Shared Revenue								
338.01 County Road Tax		5,500		5,500		1,310		(4,190)
338.99 Other		-		-		4,775		4,775
340 Charges for Goods and Services:								
341 General Government		-		-		1,201		1,201
350 Fines and Forfeits:								
351 Court Fines and Costs		3,500		1,155		1,159		4
360 Miscellaneous Revenue:								
361 Investment Earnings		-		-		43		43
363.01 Principal Collected by County		-		-		1,000		1,000
364.01 Maintenance Assessments		65,000		80,000		82,398		2,398
369 Other		12,670		17,250		21,626		4,376
Total Revenue		894,988		916,795		933,627		16,832

CITY OF SUMMERSET

BUDGETARY COMPARISON SCHEDULE - BUDGETARY BASIS (CONTINUED)
GENERAL FUND
FOR THE YEAR ENDED DECEMBER 31, 2011

					В	Sudgetary Basis -			
	<b>Budgeted Amounts</b>				Actual				
	9	<u>Original</u>		<u>Final</u>	4	<u>Amounts</u>	7	<u>/ariance</u>	
Expenditures:									
410 General Government:									
411 Legislative		49,740		46,700		37,808		8,892	
412 Executive		26,860		34,755		26,334		8,421	
413 Elections		1,465		940		921		19	
414 Financial Administration		235,333		208,791		198,762		10,029	
419 Other		-		66,320		66,033		287	
420 Public Safety:									
421 Police		189,950		212,860		201,519		11,341	
422 Fire		3,000		· <u>-</u>				•	
423 Protective Inspection		15,625		14,300		14,200		100	
430 Public Works:						ŕ			
431 Highways and Streets		306,845		237,619		243,641		(6,022)	
432 Sanitation		23,990		24,175		41,041		(16,866)	
433 Water		-		-		-		•	
440 Health and Welfare:									
444 Humane Society		16,800		4,700		4,670		30	
450 Culture and Recreation:		•		·		,			
451 Recreation		2,500		_		-		•	
452 Parks		3,950		3,550		3,508		42	
460 Conservation and Development:		·		,		,			
465 Planning and Zoning		36,931		39,006		30,247		8,759	
470 Debt Service		· <b>-</b>		-		39,600		(39,600)	
Total Expenditures		912,989		893,716		908,284		(14,568)	
Other Financing Sources (Uses):									
391.01 Transfers In		18,000		57,745		37,551		(20,194)	
511 Transfers Out		-		(80,825)	_	(78,681)		2,144	
Total Other Financing Sources (Uses)		18,000		(23,080)		(41,130)		(18,050)	
Net Change in Fund Balance		(18,001)		(1)		(15,787)		(15,786)	
Fund Balance - December 31, 2010		285,970		285,970		285,970		-	
Fund Balance - December 31, 2011	\$_	267,969	\$	285,969	\$	270,183	\$	(15,786)	

The notes to the required supplementary information are an integral part of this statement.

### NOTES TO REQUIRED SUPPLEMENTARY INFORMATION DECEMBER 31, 2011

### (1) Budgets and Budgetary Accounting

The City follows these procedures in establishing the budgetary data reflected in the financial statements:

- 1. At the first regular board meeting in September of each year or within ten days thereafter, the governing board introduces the annual appropriation ordinance for the ensuing fiscal year.
- 2. After adoption by the governing board, the operating budget is legally binding and actual disbursements for each purpose cannot exceed the amounts budgeted, except as indicated in item number 4.
- 3. A line item for contingencies may be included in the annual budget. Such a line item may not exceed 5 percent of the total municipal budget and may be transferred by resolution of the governing board to any other budget category that is deemed insufficient during the year.
- 4. If it is determined during the year that sufficient amounts have not been budgeted, state statute allows the adoption of supplemental budgets.
- 5. Unexpended appropriations lapse at year end unless encumbered by resolution of the governing board.
- 6. The City did not encumber any amounts at December 31, 2011.
- 7. Formal budgetary integration is employed as a management control device during the year for the general fund.
- 8. Budgets for the general fund and special revenue funds are adopted on a basis consistent with the cash basis of accounting.

### (2) GAAP Budgetary Accounting Basis Differences

Financial statements prepared in conformity with the cash basis of accounting would present capital outlay expenditure information in a separate category of expenditures. Under the budgetary basis of accounting, capital outlay expenditures should be reported within the function to which they relate. For example, the purchase of a new fire truck should be reported as a capital outlay expenditure on the Governmental Funds Statement of Revenues, Expenditures and Changes in Fund Balances; however, in the Budgetary Comparison Schedule, the purchase of a fire truck should be reported as an expenditure of the Public Safety/Fire Department function of government, along with all other current Fire Department related expenditures.



810 Quincy Street
P.O. Box 3140, Rapid City, South Dakota 57709
Telephone (605) 342-5630 □ e-mail: ktllp@ktllp.com

# INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS

City Commissioners City of Summerset Summerset, South Dakota

We have audited the cash basis financial statements of the governmental activities, the business-type activities, and each major fund of the CITY OF SUMMERSET (the City) as of and for the year ended December 31, 2011, which collectively comprise the City's basic financial statements, and have issued our unqualified report thereon dated September 6, 2012. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States.

### **Internal Control over Financial Reporting**

In planning and performing our audit, we considered the City's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the City's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the City's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses and therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. However, as described in the accompanying Auditor's Comments and Closing Conference, we identified certain deficiencies in internal control over financial reporting that we consider to be material weaknesses and other deficiencies that we consider to be significant deficiencies.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the City's financial statements will not be prevented, or detected and corrected on a timely basis. We consider the deficiencies described in the accompany Auditor's Comments and Closing Conference as Findings 2011-02, 2011-03 and 2011-04 to be material weaknesses.

A significant deficiency is a deficiency or a combination of deficiencies in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the deficiencies described in the accompanying Auditor's Comments and Closing Conference as Findings 2011-01, 2011-05, 2011-06, and 2011-07 to be significant deficiencies.

City Commissioners Page Two

### **Compliance and Other Matters**

As part of obtaining reasonable assurance about whether the City's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed an instance of noncompliance or other matters that are required to be reported under <u>Government Auditing Standards</u>, which is described in the accompanying Auditor's Comments and Closing Conference as Finding 2011-07.

The City's responses to the findings identified in our audit are described in the accompanying Auditor's Comments and Closing Conference. We did not audit the City's responses and, accordingly, we express no opinion on them.

This report is intended solely for the information and use of the governing board and management of the City of Summerset, federal awarding agencies and pass-through entities, the South Dakota Legislature, and state granting agencies, and is not intended to be, and should not be, used by anyone other than those specified parties. However, as required by South Dakota Law 4-11-11, this report is a matter of public record and its distribution is not limited.

KETEL THORSTENSON, LLP Certified Public Accountants

Ketel Horstonen LLP

September 6, 2012

### AUDITOR'S COMMENTS AND CLOSING CONFERENCE DECEMBER 31, 2011

### A. SUMMARY OF PRIOR YEAR AUDIT FINDINGS AND RECOMMENDATIONS

The City does not consider the additional costs of preparing its financial statements to be necessary, so Finding 2008-01 will be repeated as finding 2011-4 for the year ending December 31, 2011.

The City has made some effort to improve the segregation of duties in the payroll area. Finding 2008-02 will be repeated as finding 2011-03 for the year ending December 31, 2011, regarding controls over utility billing.

The City has not obtained new debt in 2011 and restricted cash for debt service was correct for the year ending December 31, 2011. Finding 2009-1 will *not* be repeated for the year ending December 31, 2011.

The City is aware that the budgeting process needs to be more diligent in completing supplemental appropriations, when necessary. Finding 2008-04 will be repeated as finding 2011-07 for the year ending December 31, 2011.

The City is aware that wages and raises for all employees need to be published in the Council minutes, this portion of Finding 2009-02 will *not* be repeated for the year ending December 31, 2011. The City is also aware that time studies should be performed to substantiate the allocation of wages between funds. A portion of Finding 2009-02 will be repeated as Finding 2011-05 for the year ending December 31, 2011.

The City is aware that minimum debt reserves must be maintained to comply with debt covenants. Finding 2009-04 will *not* be repeated for the year ending December 31, 2011.

### B. FINDINGS - FINANCIAL STATEMENT AUDIT

### Material Weaknesses

Finding No. 2011-02: Debt Payments

Cause and Condition: Contract for Deed - We noted debt payments were recorded in rent expense rather than debt service expense.

Criteria and Effect: Recording debt service payments as rent expense would materially misstate the financial statements.

Recommendation: Payments for the Contract for Deed need to be recorded as debt service expense.

Response/Corrective Action Plan: The Finance Officer reclassified the payment for the Contract for Deed as debt service expense.

Finding No. 2011-03: Segregation of Duties

Cause and Condition: Proper segregation of duties assumes adequate internal control over the safeguarding of assets and the reliability of financial records and reporting. The City has a lack of segregation of duties surrounding utility billing. The Assistant Finance Officer has the ability to accept utility and other payments, prepares utility billings, posts utility payments and all City revenue, and makes adjustments to customer accounts.

Criteria and Effect: The City is susceptible to misappropriation of utility payments.

Recommendation: The Assistant Finance Officer should not have the capability to post adjustments to customer accounts, as well as accepting payments. These duties should be separated between the Finance and Assistant Finance Officers. During 2011, the City Commission began reviewing the adjustment report on a monthly basis.

Response/Corrective Action Plan: The Finance Officer will post all utility billing adjustments. The City Commission will review the same and approve at the City Commission meeting.

### AUDITOR'S COMMENTS AND CLOSING CONFERENCE (CONTINUED) DECEMBER 31, 2011

### B. FINDINGS - FINANCIAL STATEMENT AUDIT (CONTINUED)

### Material Weaknesses (Continued)

Finding No. 2011-04: Financial Statement Preparation

Cause and Condition: The City does not have an internal control system designed to provide for the preparation of the financial statements being audited, including the related footnote disclosures. As auditors, we were requested to draft the financial statements and accompanying notes to the financial statements. This circumstance is not unusual in a City of your size.

Criteria and Effect: This control deficiency could result in a material misstatement to the financial statements that would not be prevented or detected by your City's internal control system.

Recommendation: It is the responsibility of management and those charged with governance to make the decision whether to accept the degree of risk associated with this condition because of cost or other considerations.

Response/Corrective Action Plan: Monthly financial statements are submitted to the City Commission on a regular basis for their review. At such time as the Commission would feel the necessity to require statements prepared by an outside source, the Finance Officer will contact appropriate resources for assistance.

### Significant Deficiencies

Finding No. 2011-01: Bank Reconciliations

Cause and Condition: During our review of the City's bank reconciliations, we noted reconciliations were not being performed on a timely basis, and the December reconciliation did not agree to the general ledger by an immaterial amount.

Criteria and Effect: It is essential to perform bank reconciliations on a timely basis to identify and correct discrepancies for accurate financial reporting.

Recommendation: Bank reconciliations should be performed the subsequent month to identify and resolve discrepancies.

Response/Corrective Action Plan: The Finance Officer will perform bank reconciliations on a monthly basis, however due to the lack of staff, may contact the appropriate outside resources if assistance is needed.

Finding No. 2011-05: Payroll Allocation

Cause and Condition: Allocation of Payroll – Documentation did not exist supporting the allocation of payroll expenses for one of the Commissioners to the General and Sewer Funds.

Criteria and Effect: The City should accurately reflect the payroll expense in the funds that incurred the expense and received the benefit.

Recommendation: Time studies should be performed on an annual basis to substantiate how payroll is allocated between funds.

Response/Corrective Action Plan: The Finance Officer will have time studies performed for wages which will be allocated to different funds.

### AUDITOR'S COMMENTS AND CLOSING CONFERENCE (CONCLUDED) DECEMBER 31, 2011

### B. FINDINGS – FINANCIAL STATEMENT AUDIT (CONTINUED)

### Significant Deficiencies (Continued)

Finding No. 2011-06: Controls over Information Technology

Cause and Condition: We noted the following regarding information technology:

- Computer hardware and software passwords were not changed on a regular basis until 2012.
- Backups of the financial accounting software were not being tested.
- Access to the network was provided to a third party without prior approval of the Network Administrator.
- The City does not have a Document Retention Policy including provisions for computer backups.

### Criteria and Effect:

- Modifying passwords on a regular basis is necessary to ensure the City's financial information is secure.
- Testing backups on a regular basis ensures the financial data is available in case of an emergency.
- The Network Administrator must be notified prior to a third party accessing the network to ensure the security of the City's data.
- The City should maintain a Document Retention Policy which includes provisions for computer backups to ensure proper rotation.

### Recommendation:

- In 2012, the City began changing passwords on a regular basis. We recommend the City continue this process.
- We recommend backups of financial data are tested on a regular basis to ensure adequate backups are being maintained.
- We recommend the Network Administrator be notified prior to a third party accessing the City's network to ensure proper safeguards are maintained over the City's data.
- We recommend the City maintain a Document Retention Policy including provisions for computer backup rotation, to ensure electronic history of data is adequately maintained.

### Response/Corrective Action Plan:

• The Finance Officer will coordinate with the Network Administer to properly test backups, maintain safeguards over the City's network, and create a proper Document Retention Policy.

### Finding No. 2011-07: Budgetary Overdraft

Cause and Condition: The City has a budgetary overdraft in violation of South Dakota Codified Law 9-21-9, in the following departments:

430 Public Works:	 verdrait
430 Fuolic Works.	
431 Highways and Streets	\$ (6,022)
432 Sanitation	(16,866)
470 Debt Service	(39,600)

Orronden

Criteria and Effect: The City is not in compliance with State laws.

Recommendation: The City in the future should complete supplemental appropriations for unbudgeted expenditures.

Response/Corrective Action Plan: The Finance Officer will complete supplemental appropriations for unbudgeted expenditures. During the current year the payroll and contract for deed payments had been reallocated to expenses other than where budgeted, this has been resolved subsequent to year end.